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THE EUROPEAN DEBT CRISIS AND CHANGING STRATEGY OF CBRT

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ABSTRACT

Due to the size of implemented stability program against the global crisis, there has been a serious debt problem for especially developed economies. When the economies of the developed countries which have already high debt ratios have again slown down, expectations about debt rollover distorted and borrowing costs increased. Concerns about sustainability of debts have caused to a new crisis expectations. In the summer of 2011, a new economic crisis rhetoric has entered to literature. It has been generally called European Debt Crisis. Becauce the main economic problem has been the debt. Borrowing costs have risen sharply. For facilitating and cheapening the borrowing, liquidity taps have been opened. This expansionary monetary policies also aim; ensuring the re-functioning of the credit mechanism, supporting economic growth by keeping credit costs low and removing the risks of the financial system. To maintain the economic stability at the global economic crisis environment, a new monetary policy has adopted by Turkish monetary authority. New policy combination consisting of policy interest rate, interest rate corridor and statutory reserves provides elasticity for monetary policy against the crisis. New monetary policy has differed from previous one in some aspects. The aim of monetary policy moves to financial stability from price stability. In crisis environment, current account deficit is getting the major risk of Turkey economy. Avoiding this risk, CBRT has changed the policy of high interest rate - low exchange rate.

Key Words: monetary policy, financial stability, policy interest rate, interest rate corridor, statutory reserves

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AVRUPA BORÇ KRİZİ VE TCMB'NİN DEĞİŞEN STRATEJİSİ

ÖZET

Küresel krize karşı uygulanan istikrar programlarının büyüklüğünden dolayı, özellikle gelişmiş ekonomilerde ciddi borç sorunları başgöstermiştir. Halihazırda yüksek borçlanma oranlarına sahip gelişmiş ekonomilerde yavaşlama, borçların yönetilmesiyle ilgili beklentileri bozmuş, borçlanma maliyetlerini yükseltmiştir. Borçlanmanın sürdürülebilirliğine ilişkin kuşkular yeni bir kriz beklentisine neden olmuştur. 2011 yılının yazında, Avrupa Borç Krizi olarak adlandırılan yeni bir kriz söylemi yaygınlaşmıştır. Çünkü temel ekonomik sorun borçtur. Borçlanma maliyetleri hızla artmaktadır. Borçlanmayı ucuzlatmak ve kolaylaştırmak için likidite muslukları açılmıştır. Bu genişletici politikalar ayrıca kredi mekanizmasının yeniden çalışmasını temin etmek, kredi maliyetlerini düşük tutmak suretiyle ekonomik büyümeyi desteklemek ve mali sistem riskini ortadan kaldırmayı da amaçlamaktadır. Küresel kriz ortamında ekonomik istikrarı sürdürmek için Türk parasal otoritesi yeni bir parasal politika benimsemiştir. Yeni politika bileşimi krize karşı para politikasına esneklik sağlayacak politika faiz oranı, faiz koridoru ve kanuni rezerv politikalarından oluşmaktadır. Yeni parasal politika öncekinden bazı yönlerden farklılaşmaktadır. Para politikasının hedefi fiyat istikrarından finansal istikrara kaymıştır. Kriz ortamında cari açık ekonominin en önemli riski olarak ortaya çıkarken bu riskin üstesinden gelinebilmesi için TCMB yüksek faiz düşük kur politikasını değiştirmiştir.

Anahtar Kelimeler: para politikası, finansal istikrar, politika faizi, faiz koridoru, zorunlu karşılıklar

INTRODUCTION

Turkish economy has been affected seriously by the crisis in 2008. But it has eluded very quickly from the crisis. By 2011, discussions on overheating have been made. Even, measures have been taken against overheating such as slowing down the demand and reversing the credit expansion. The government has increased the tax rates, and The CBRT has increased the reserve ratio. Because the measures are not sufficiently effective, on credit growth has been put the ceiling and loan provision has been increased. (The CBRT, 2012a:3) The Central Bank has implemented measures against the exchange rate appreciation. By raising the interest rates, the necessity of encouraging the saving and discouraging the consumption is expressed. By the way the global financial crisis has broke out.

While economy management is to take new cooling measures, The CBRT forecasts have changed. It has foreseen the confusion in the financial markets and the recession in developed countries. Act proactively, it has reduced the policy rate, narrowed the interest rate corridor and declared that provide foreign currency liquidity. (The CBRT, 2012b:2) During this period, state-owned banks have reduced deposit rates. The Treasury borrowing rates is tried to realize in line with interest rate policy of The CBRT. Decline in interest rates aims the increase in exchange rate by reducing capital inflows. Current account balance will be provided with the increase in foreign exchange rate. The route of transmission of the crisis on the Turkish economy will be the current deficit. Therefore, the current account deficit as a priority in this period has been tried to be solved. Crisis proceeds, external financing is getting more difficult and the cost of it will be high. External financing requirement will be a serious crisis dynamics.

In second section, the European debt crisis and monetary - fiscal policy measures against the crisis of European economies are examined. In third section, reasons and requirement of changing monetary policy, fiscal dominance and effectiveness of monetary policy are studied. In fourth section, new monetary policy of Turkey economy is tried to understand. In conclusion section, final opinions are expressed.

1. THE EUROPEAN DEBT CRISIS

There has been a serious debt due to the size of the implemented program. Debt has been risen because of the ultimate costs of the financial crisis, the rate of real growth and the level of interest rates, as well as political decisions about spending and taxes. (Cecchetti, Mohanty and Zampolli, 2010:1) When the economies of the developed countries which have already high debt ratios have again slown down, expectations about debt rollover distorted and borrowing costs increased. (Baldacci and Kumar, 2010:4) Concerns about sustainability of debts have caused to crisis perception. (Candelon and Palm, 2010:81)

In the summer of 2011, a new economic crisis has entered to literature. It has been generally called European Debt Crisis. Becauce the main economic problem has been the debt. Fears have led to increase in risk premium. (Baldacci and Kumar, 2010:7) A country, with a higher risk of default, faces a higher refinancing cost of public deficits. (Candelon and Palm, 2010:83) Borrowing costs have risen sharply. Economy managements have decided to fight against crisis with financial policies. Aim of the financial policies has been facilitating and cheapening the borrowing. (Watt, 2009:19) For this, access to liquidity has been eased. By opening the liquidity taps, quantitative expansion has been made. Interest rates have reduced for decreasing the cost of money. (Mishkin, 2011:26) This expansionary monetary policies aim; ensuring the re-functioning of the credit mechanism, supporting economic growth by keeping credit costs low and removing the risks of the financial system. In the absence of sterilization after a suitable time, there is a risk of inflation arising from quantitative expansion. (Aizenman and Glick, 2009:788)

Unlike the monetary policy, it is not easy to use fiscal policy in the EU. (Lane, 2012:49) The most important reason of this difficulty is The Principle of Subsidiarity. There is only one authority in monetary policy: European Central Bank. (Arestis, McCauley and Sawyer, 1999:32) Single headed monetary policy is applied easily and quickly. But there are lots of authority in fiscal policy. (Inman and Rubinfeld, 1998:13) Each country is a independent fiscal authority. (Wyplosz, 2002:13) Namely, fiscal policy is multi headed. Therefore, it cannot be applied as easily and quickly as monetary policy. (Brunila, 2002:11) Because of these reasons, at the beginning of the crisis, only monetary policy has been used. (Hodson and Quaglia, 2009:940)

Primary surplus is used as an anchor when there are high debt stock, high cost of borrowing and strong doubts on the refinancing of debt. (Karakurt and Akdemir, 2010:246-247) It is also used by IMF as a performance criterion. (Ceylan, 2010:392) Primary surplus is also one of the methods developed to targeting and analytical measuring the annual performance of public institutions. (Cansız, 2006:69) Primary surplus is from the remaining budget revenues after primary expenditure.(Tanner and Ramos, 2002:3) Debt stock is increased in economies continuously giving primary deficit.(İnan, 2003:19) The primary surplus is important in two respects. The first important point is guarantee to the creditors. Under heavy debt burden, only tight fiscal policies and the primary surplus can ensure the debt sustainability.(Gürdal, 2008:422) The second point is relieve of the pressure on borrowing. (Heinemann and Winschel, 2001:3) Creating additional resources to pay interest may lower the borrowing requirement as well as real interest rates.(Özmen and Yalçın, 2007:8)

Before global crisis, there has been primary surplus nearly in all countries. In 2008, worsening has started. In the most severe crisis year, all countries has given primary deficit. In 2010, primary deficit has slightly decreased. In some European countries, the budget deficit has reached very high levels. In two years, primary deficit has realized 15,6% in Greece, 16,8% in Spain, and 16,9% in the UK. In 2011 and 2012, the trend of government deficit has continued. Source of the doubts about sustainability of debts is this. Without common improvement in primary balance, the possibility of deepening in the European Debt Crisis has more and more increased.

Table 1: Government Balance (% of GDP)

	2007	2008	2009	2010	2011	2012	2013
EU	1,8	0,4	-4,3	-3,9	-1,5	-4,2	-3,2
Euro Zone	2,3	0,9	-3,5	-3,4	-1,3	-3,6	-2,9
Germany	3	2,7	-0,5	-1,8	1,7	0,1	0,1
Greece	-2	-4,8	-10,6	-5	-2,2	-8,6	-12,2
Spain	3,5	-2,9	-9,4	-7,4	-6,9	-10,3	-6,8
France	0	-0,4	-5,1	-4,6	-2,6	-4,9	-4,1
Italy	3,4	2,5	-0,8	-0,1	0,9	-3	-2,8
Portugal	-0,2	-0,6	-7,3	-6,8	-0,4	-5,5	-4,9
England	-0,5	-2,7	-9,5	-7,4	-4,6	-8,3	-5,8

Source:Eurostat

As a result of public deficit, public debt stock has increased rapidly. In 3 years, total debt stock of EU 27 has grown €1,7 trillion. Almost all of the deficit has stem from three important counties: Germany, France and especially England. The most remarkable increase has realized in England. Debt stock of England has grown over €600 billion. France and Germany are also prominent countries. Both of them have realized nearly €400 billion increase in 3 years. Debt ratio of EU has risen from 59% in the end of 2007 to 85,4% in the end of 2013. Increase is nearly 50%. In Euro Zone, public debt stock reaches 90% of total GDP. Deterioration in France, Spain, Portugal and England is dramatical.

Table 2: Gros Public Debt (Billion Euro) (% of GDP)

	2007	2008	2009	2010	2011	2012	2013	2007	2008	2009	2010	2011	2012	2013
EU								59	63	75	80	80,8	83,5	85,4
Euro Zone								66	70	80	85	85,8	89	91
Germany	1593	1660	1778	2067	2096	2174	2159	65	67	74	83	78	79	77
Greece	240	265	301	330	356	305	319	107	113	129	145	171	157	175
Spain	384	440	569	649	744	891	966	36	40	54	61	69	84	92
France	1249	1354	1527	1628	1749	1866	1949	64	68	79	82	85	89	92
Italy	1606	1671	1770	1851	1908	1990	2070	103	106	116	118	116	122	128
Portugal	120	128	147	173	196	212	219	68	72	83	93	111	125	128
England	880	822	1099	1384	1585	1741	1793	44	55	70	80	82	86	87

Source:Eurostat

Recession risk and weak growth, continuing budget deficits, height of the borrowing requirement and increase in debt stocks have led to doubts about debt sustainability. Borrowing costs are increasing in all Euro Zone countries. (Table 3) CDS Premiums of EU countries have risen sharply. The sturdiest economy of EU is Germany and CDS premium of Germany has tripled in two years. Short term interest rates have risen nearly 50% in general. Considering the size of the debt stock, the burden on the budgets can be better understood.

Table 3: Borrowing Costs

	CDS Premium		Short Term Interest Rates	
	2009-9	**2011-9**	**2009-9**	**2011-7**
Germany	91	271	2,43	3,13
France	81	284	1,84	2,94
Italy	58	472	2,28	3,32
Spain	152	823	2,66	3,68
Portugal	87	1.066	4,36	6,14
Ireland	631	514	2,82	3,81
Greece	144	2.246	3,62	5,91

Surce: ECB

Economic growth cannot be possible. Growth can prevent the rise of debt ratio, build capacity for debt payment, eliminate the need of new debt. (Padoan, 2009:12) Public sector demand cannot be risen because of budget deficit. Economies cannot carry out growth and it is the most important reason of the crisis. The current situation requires some measures. First of all, the expansionary applications are observed in monetary policy. (Fahr, et al, 2010:27) The FED and the ECB continue to provide emission. FED keeps interest rates historically low levels and the ECB decreases the level of interest rate. (Development Ministry of TR, 2011:70) The European Central Bank operates an uncontrolled quantitative easing policy. (Table 6) In less than two years, ECB has expanded monetary base from €1,9 trillion to €2,8 trillion and central bank assets from €2,5 trillion to €3,5 trillion. (International FinancialStatistics) At the end of 2011 and the beginning of 2012, with two separate tender, ECB has provided credit to European banks more than €1 trillion. Uncontrolled monetary expansion combined with the deepening recession can be a powerful push to the stagflation.

Thus, low-cost and abundant liquidity is offered to the market. Here is expected to: preventing the banks liquidity problems, providing the borrowing capacity for troubled countries, and providing competitive advantage in international trade by depreciating the exchange rates. Quantitative easing implemented by the developed countries to the crisis has led to inevitable appreciation of the developing countries' currencies. Developing countries are trying to hinder the local currencies appreciation process. This process negatively affects the current account balance, exports and imports. It can be said that low density currency war has begun.

The main objective of fiscal policy has become to ensure fiscal discipline. Better enforcement of fiscal discipline will likely have two key components: Stricter enforcement of current rules, and more fiscal coordination. (Darvas, 2010:13) The primary surplus will be created and it will be used to debt paying. However, the measures to be implemented to create a primary surplus is likely to deepen the economic recession. But, an economic theory called expansionary fiscal contraction hypothesis says different thing: Declining public expenditure could cause an economic boom by improving market confidence and expectations. (Barry and Devereux, 1995:249) Fiscal discipline can change the consumer behavior by increasing consumer confidence. (Erdoğan, 2007:118) A fall in expected inflation stimulates consumption and reduces interest rates, a fall in real interest rates raises wealth and consumption, a fall in the long-term real rate of interest stimulates investment and substitution of private for public consumption is an additional direct channel between fiscal policy and private expenditure. (Giavazzi and Pagano, 1990) The most important weakness of fiscal policy is different public finances of each country. (Calmfors, 2010:9) There is a single authority in monetary policy, but there are fiscal policy authorities as much as country number. (Uhlig, 2002:2)

For European financial system, it is discussed to be taken serious measures. The priority is the relief of the banks with risky bonds. For this purpose, in collaboration with the EU and IMF, EFSF (European Financial Stability Facility) fund was established. EFSF aims at working with a source of €800 billion. (EFSF, 2011:1) Some economists assert that troubled countries should quit from monetary union and they should devaluate the local currencies. (Hellwig, 2011:8) Exit from crisis will be easier and quicker. Local currency depreciation will support economic growth by providing a competitive advantage. When converted in local currency, debts will decrease seriously in real terms. European banking system holding high amounts of bonds may face systematic collapse. Some banks have as large PIIGS bond stock as that there will be no equity after this bond stock. For example, Dexia's PIIGS bond stock is 130% of its equity. (economist.com, 2011)

2. CHANGES IN MONETARY POLICY

The CBRT has done a paradigm shift in the Turkey economy for lowering effect of the relapsing global crisis. Before the emergence of the global financial crisis, some monetary policy measures has been taken against the current deficit. However, with deepening the crisis in Europe, a more radical approach requirement has emerged. This new approach has shown itself as a new monetary policy. When examining change in monetary policy, firstly reasons and necessity of the change are analyzed then fiscal dominance is observed in Turkey economy as a limit of the monetary policy effectiveness.

2.1. Reasons and Requirement of Policy Change

Turkey is a developing country with increasing population. It needs investment and new employments. There is no opportunity to the investment be financed fully by domestic savings. Economy management has chosen to use foreign savings to increase investment and employment. (Rodrik, 2009:15) Application of a high interest rate policy makes the foreign capital inflows increase. Thus, the necessary capital to invest can be obtained.

Turkey economy has current account deficit as a result of the savings gap. Exchange rate plays a key role. Keeping capital inflows high, high interest rate makes the exchange rate stand low. Capital inflows over the current account deficit is crucial. If capital inflows are not sufficient to cover the current account deficit, exchange rate begins to rise and perturbs the equilibrium. In this case, interest rates will need to increase sufficiently. Exchange rate may remain lower with sufficiently high interest rate. Investments that would increase employment and growth will be financed by foreign savings. Exchange rate is closely related to the level of the price. Overvalued TL has allowed oppression over the inflation. Exchange rate pass-through is high in the Turkey economy. (Choudri and Hakura, 2001:5) An upward movement in the exchange rate is a serious risk for price stability.

Before the relapse of the global financial crisis, to ensure the continuity of the economic paradigm outlined above, The CBRT keeps interest rates high and ensures the exchange rate be low. (Akıncı et al, 2005:5)As the level of the current account deficit becomes the most important risk of the economy, taking the precautions has become necessary. Continuation of the high interest-low exchange rate policy may be possible only by continuous increasing the interest rates. Sustainability of this policy is debatable. (Kalyoncu, 2006:1) CB is able to provide continuity of the policy by raising the policy interest rates each time. The current account deficit and the private sector external debt arising from the current account deficit are an important points of fragility in the economy. To the estimation of Cline and Williamson (2011:14) overvaluation of TL from February 2008 to April 2011 has reached 40%. This significant increase in currency can cause extensive damage to private sector. Import-dependent production caused by the policy of overvalued TL is the major cause of the current account deficit and high external debt of the private sector. Increasingly ingravescent crisis in Europe, the most important export market of Turkey, leads to a significant shrinkage of foreign demand. In order to avoid a crisis arising from the current account deficit, firstly the need of changing monetary policy that caused to the current account deficit has emerged.

Probably the most important reason for the change in monetary policy is Euro Crisis of which Turkish economy began to feel the effects. Continuation of the policy of high interest rates and low exchange rates does not seem to possible in the crisis environment. Considering the impossibility of keeping exchange rates low, The CBRT have chosen not to increase interest rates in order to avoid unnecessary interest costs exposure of economy. Even a symbolic interest rate cut has been made. (SPO, 2011:102) Thus, it has signaled to the markets awaiting increase in the interest rates. The stability of the economy not the price stability has been highlighted by CB.

It can be said that there is no place for the inflation targeting in new design of CBRT. The CBRT refers to this change as follows: in order to keep the macro-financial risks under control, The Central Bank has established the new monetary policy strategy by developing the inflation targeting regime in the last year. (CBRT, 2012a:2) It can be explained in three aspects. The interest rate instrument is used to provide convergence to the target in inflation targeting strategy. If the target is price stability, monetary policy will not be able to use for any purpose other. In the event of putting economic stability as the aim of monetary policy, the abandonment of inflation targeting is mandatory. Second, the increase in exchange rate will cause an increase in inflation. The price pass-through of exchange rates is known to be high in the Turkish economy. Third, the increase in inflation will be limited due to the recession in world economies. Declines in the prices of energy and raw materials has limited the impact of the increase in foreign exchange rates. For this reason, the implementation of a policy towards exclusively inflation is unnecessary.

CB thereby has given up de facto from inflation-targeting policy. This change in the policy has been criticized severely by the some economists. The Central Bank is working to ensure economic stability instead of price stability.(CBRT, 2012c:2) The Bank determines the policy mix to retain minimum level of effect of the global economic crisis and it is throwing the purpose of price stability into the background. In fact, there are doubts in the economics literature regarding inflation targeting. Some economists express inflation targeting policy passes on unjustified resource to the capital sector by keeping interest rates unnecessarily higher. When there are more important issues, it diverts the economy by creating an artificial agenda.

2.2. Fiscal Dominance and Effectiveness of Monetary Policy

The public financial structure problems that caused the crisis in developed countries don't exist in developing countries. The Turkish economy doesn't live the issue of public financial structure, either. Economy has been caught the global financial crisis with a robust public finances. Indebtedness is low and the budget balance is stable, trend is positive. The budget is in surplus. (SPO, 2011:108) Due to the high import and high growth, tax revenues remain high. Due to restructured social security and tax receivables, budget revenues has increased by a substantial number. Interest expenditures has decreased. Despite the increase in non-interest expenses, increase in total budget expenditures has been limited. As the first nine months the primary surplus amounted to TL 34 billion. (SPO, 2011:108) By the end of the year 2011 it has been estimated that budget deficit won't exceed 1% of GDP.(IMF, 2011:4) During this period, borrowing is under the redemption. The EU defined gross debt is at the level of 42,2%. (Undersecretariat of Treasury, 2011a:4)

Through fiscal discipline and efficient management of the public debt;

- EU definition of gross public debt burden has drawn far below the EU-27 average,
- Net Public Sector Debt Stock is significantly reduced as a share of national income,
- Interest expenses has been reduced as a share of tax income,
- The maturity and currency composition of the debt have been significantly improved. (Undersecretariat of Treasury, 2011b:3)

Through fiscal discipline, fiscal dominance has not appeared at the beginning of the crisis. Thereby effectiveness of monetary policy has not decreased. Unlike developed economies, the Turkish economy has a margin to implement expansionary fiscal policy. Because of the strong demand, high investment and growth ratio, there is no need to implement an expansionary fiscal policy. On the contrary, the fiscal policy needs to tighten because of live internal demand. At the very beginning of the global crisis, the main economic issue of the Turkish economy has been foreign trade deficit. Due to the risk of disrupting the expectations by the global financial crisis, the economy management has refrained from implementing contractionary fiscal policy.

3. NEW MONETARY POLICY

CBRT has started to implement new policy mix consist of policy rate, interest rate corridor and reserves. (CBRT, 2012a:2) CBRT has adopted the diversity of instruments. The reason of this instrument diversity is the objective diversity. (CBRT, 2012a:2) These objectives are price stability and macro financial stability elements. (CBRT, 2012a:2) Thus the first feature of the monetary policy is emerged: price stability-oriented monetary policy disappears. Instead, composed a new framework aims at controlling the destabilizing macroeconomic factors and risks to the economy in general. Global turmoil and current deficit problem have been seen as destabilizing macroeconomic factors by CBRT.

The first component of the new monetary policy is policy rate. The most important problem of the Turkish economy is current deficit. Interest rates has been kept high for many years. Continuation of this policy for many years has deterred the production of domestic intermediate goods. So, the current deficit has become structural. Desire of permanently low interest rates has become an approach for tackling the structural current account deficit. Through the high interest rates, inflation has been kept under oppression and foreign capital inflow for financing development has been provided. Remedy of the current account deficit issue is directly related to the exchange rate value. Low interest rates eliminate the chronically valuable native currency. In this case, inflation inevitably deviates. Namely, transition from price stability to financial stability.

The second and the most important component of the new monetary policy is interest rate corridor. A new approach to monetary policy contains a serious deviation from previous policies on the interest subject. The previous paradigm of monetary policy has been the high interest rate and low exchange rate. After, this paradigm has changed. The next paradigm has been the low interest rate and high exchange rate. In the last monetary policy, interest rate is flexible. Interest rates corridor application provides flexibility for interest rate policy. Interest rate corridor is defined as the difference between borrowing and lending rates. Monetary authority can intervene to market interest rates without changing the policy rate via interest rate corridor. The global crisis environment, it needs to take measures according to the direction of fluctuation against short-term fluctuations. The interest rate corridor gives opportunity to the Central Bank intervention according to the direction of the market volatility. Interest rate corridor, through the level of capital flows and exchange rates, is working to resolve destabilizing effects of inflation and current account deficit. There is no commitment on exchange rate or any foresight about the level of exchange rate. But, central bank is trying to provide exchange rate movement within a limited band. This band should not nourish inflation or current deficit. The interest rate corridor is used to keep the exchange rate on the desirable level. When capital inflows, native currency appreciates. It is tried to eliminate the effect of creating current account deficit of overvalued native currency. If there is capital outflow, native currency depreciates. The interest rate corridor is used to prevent the exchange rate from falling below a desirable level. It is tried to eliminate the inflationist effect of depreciated native currency.

4. CONCLUSION

Problems arising from the uncontrolled financial market have led to a global crisis started in developed economies in 2008. To overcome this crisis, advanced economies have pursued expansionary monetary and fiscal policies. These policies have caused to a strong return of crisis after a short period of time. There is a tolerance limit of monetary and fiscal policy in first crisis but in second crisis there is no tolerance limit. In the first crisis, abundant amount of money is printed. So that economies moving towards liquidity trap. Central bank balance sheets have grown extremely. Now you should have done sterilization, no margin of quantitative easing, especially ECB continues to print money in an uncontrolled manner. In the first crisis, fiscal policy is used extremely, too. Return of the crisis has realized via borrowing.

Economy managements could not get quick decision and implementation is late. This situation has caused to quickly deepening of the crisis. The United States has been late to take measures due to the contestations between the executive and the legislature, so the crisis has deepened. Europe is of a fragmented structure that taking and implementing the decision is nearly impossible. The benefit of each country necessitates a different approach.

Measures against to 2011 crisis can be grouped under three headings: expansionary monetary policy and contractionary fiscal policy measures, establish a fund to share the risks of the financial sector. Trying to supply cheap and plentiful liquidity. It is intended to re-functioning of banking mechanism. It may stimulate the demand, too. Fiscal policy is intended to reduce the borrowing requirement by ensuring fiscal discipline. Policy of the cheap money is the major risk of this policy mix. Because of shrinking economies, it can cause to inflation even to stagflation. In this case, the welfare loss of the middle classes may lead to the political consequences. It can be said that the 2008 crisis has induced a Arab Spring process by hitting the middle classes of North Africa. This time, initiate a similar process in the European middle class.

Contractionary fiscal policy measures must be very severe. Magnitude of the problem has compelled to the severe measures. Severe measures may exacerbate the contraction in the economy. Weaker demand and shrinking economies may further disrupt the budget balance. In this case ratios of the borrowing further deteriorate. Another risk is the increase in the cost of borrowing. Budget Balances are severely affected. Debt rollover gets difficult. Concerns regarding the will of decision-making and implementation have been raised. But the democratic mechanisms obstruct the process. The third measure relates to risk of the banks carrying the government bonds. This risk can cause the collapse of the European financial system. The fund aims to reduce this risk of the banking system.

Before outbreak of European Crisis, the most important issue of Turkish economy is foreign trade deficit. Inflation targeting policy has been implemented at the time. To reach the inflation target, exchange rate is under pressure. Overvalued native currency causes to foreign trade disadvantages. Before European crisis, Turkish monetary authority has varied. It has been observed marks of a paradigm change in monetary policy. The previous paradigm of monetary policy has been the high interest rate and low exchange rate. After, this paradigm has changed. The next paradigm has been the low interest rate and high exchange rate. For reducing the current account deficit, a small amount of exchange rate depreciation has been adopted. The reason of the overvalued TL is high interest rates. The decline in interest rates provides depreciation of the exchange rate. So, foreign trade deficit can be reduced. CBRT has begun to reduce policy rates. In addition, it has begun to buy foreign currency. The aim has been high exchange rates. The new monetary management has thought that a few points of inflation is not important than dangerous rise in the current account deficit. So, the main target of monetary policy has evolved from price stability to financial stability.

Has begun to implement this policy, the crisis broke out. Fluctuations in European economies have forced the Turkish monetary authority to take necessary measures. Priority of the monetary policy is given to remove the effects of the global financial crisis. Instruments ensuring the flexibility to monetary policy have been used. The global crisis environment, it needs to take measures according to the direction of fluctuation against short-term fluctuations. The policy of low interest rate and high rate of exchange has been changed. The life of the policy has been short. The new policy is flexibility. The main target of monetary policy has again evolved from financial stability to economic stability.

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